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In The

SUPREME COURT OF THE UNITED STATES

October Term, 1998

UNITED STATES OF AMERICA,
Respondent,

v.

DAYS INNS OF AMERICA, INC. AND HFS INCORPORATED,
Petitioners.

Petition for a Writ of Certiorari to the
United States Court of Appeals for the Eighth Circuit

BRIEF OF THE INTERNATIONAL FRANCHISE ASSOCIATION AS *AMICUS CURIAE* SUPPORTING PETITIONER

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CONSENT TO FILE
AMICUS CURIAE BRIEF

The International Franchise Association has obtained written consent from counsel of record for the Petitioners, Days Inns of America, Inc. and HFS Incorporated, and for the Respondent, the United States of America, to file this *Amicus Curiae* Brief in support of Petitioner's Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit. The written consent of each party's counsel is attached to the Certificate of Service filed simulteneously herewith.

INTEREST OF THE *AMICUS CURIAE*

The International Franchise Association ("IFA") respectfully submits this brief as *amicus curiae* in support of the petition for a writ of certiorari by Days Inns of America, Inc. and HFS Incorporated (collectively, "DIA").[1] IFA supports the petitioner's position that the United States Court of Appeals for the Eighth Circuit erred in holding that DIA could be liable under Section 303 of the Americans With Disabilities Act, 42 U.S.C. § 12183, for noncompliance with the ADA by a franchised Days Inn hotel.

IFA was founded in 1960. It is the oldest and largest association in the world representing the interests of franchising. IFA's current membership includes more than 700 franchisors in over 60 industries. IFA opened membership to franchisees in 1993, and today has franchisee members representing more than 30,000 franchised outlets. IFA serves as a resource center for current and prospective franchisors and franchisees, state and federal government agencies, and the public. IFA also represents the interests of franchising before legislatures, courts and the public.

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[1] Counsel for DIA did not author this brief in whole or in part. Neither DIA nor any other person or entity made a monetary contribution to the preparation of this brief, other than indirectly by payment of normal membership dues to IFA.

DIA's petition is of vital interest to IFA and its members. This case turns on a federal statutory question of general applicability to franchisors. An estimated 600,000 franchised outlets are operating in the United States today – a substantial proportion of them designed and constructed after the ADA's new construction standards took effect. Thousands more are developed every year. Moreover, franchise agreements commonly contain controls over design and construction similar to those in the Days Inn franchise agreement at issue in this case. Accordingly, the Eighth Circuit's decision that DIA could be liable under Section 303 for its franchisee's failure to design and construct a franchised hotel in compliance with the ADA has broad implications for franchising.

IFA will not reiterate DIA's legal arguments in support of its petition. Instead, this brief addresses practical and public policy considerations that IFA believes should inform this Court's decision whether to accept the case.

REASONS FOR GRANTING THE PETITION

I. THE QUESTION OF FRANCHISOR LIABILITY FOR FRANCHISED FACILITIES UNDER SECTION 303 OF THE ADA HAS BROAD ECONOMIC IMPLICATIONS.

Franchising is a major force in the U.S. economy. It is estimated that at least 40% of all retail sales are made from outlets of franchised networks. Thousands of franchisees start up new businesses every year, adding to the 600,000 franchised outlets already in operation. The question of franchisor liability under Section 303 therefore directly affects a vast number of franchise relationships and, through them, a huge segment of the economy.

A franchise is a contractual relationship in which the franchisor, the owner of a business concept and associated trademarks or service marks, authorizes an independent franchisee to conduct business under the franchisor's marks using the franchisor's format and business methods. The franchise relationship is a careful balance of risks and rewards. The franchisee reduces its risks by affiliating with a recognized name and business concept; the franchisor reduces its risks by not having to furnish the labor and capital for the franchised location. In exchange for the reduced risk, each party accepts a lesser reward than it might have obtained by acting independently: the franchisee typically pays a small percentage of its gross sales to the franchisor as an ongoing royalty, and the franchisor accepts the royalty in

lieu of the net income it might have earned from operating a company-owned business at the location.

The Eighth Circuit's ruling fundamentally alters the balance of risks and rewards that underlies franchise relationships. It equates the legal risk of the franchisor with that of the franchise owner, without the potential rewards of ownership – and thereby curtails the incentive to franchise at all. In the hundreds of thousands of franchise agreements in place today, the initial franchise fee and ongoing royalty were set based on the assumption that franchisees would be responsible for their own regulatory compliance, including compliance with the ADA. That assumption is legitimate; for example, federal, state, and local governments have never required franchisors to obtain building permits or business licenses for franchisees' businesses. The payments due to the franchisor under the franchise agreement do not take into account the unanticipated compliance burden that the Eighth Circuit's decision imposes, nor the litigation cost that will surely result from the decision.

The franchisor inevitably has less incentive to share profits with franchisees – *i.e.*, to grant franchises – if the franchisor will have to bear the same burdens as if it owned the franchised facility. This increased exposure, at a minimum, would lead to higher costs for new franchise investors, as franchisors increase fees to offset their new obligations. As a result, fewer entrepreneurs would garner the advantages of self-employment, the enhanced credibility gained by association with the name and quality standards of a franchise system, and the opportunity to

avoid costly mistakes that the franchisee might otherwise make in operating on its own.

The Eighth Circuit's interpretation of Section 303 thus threatens serious dislocations in franchising. Moreover, as set forth in detail in DIA's petition, conflicting interpretations of Section 303 seem destined to collide in the federal circuit courts of appeal. This Court could easily prevent these unnecessary and undesirable effects by issuing a writ of certiorari to review the erroneous Eighth Circuit decision.

II. THE EIGHTH CIRCUIT'S DECISION IGNORES PRACTICAL AND LEGAL LIMITATIONS ON FRANCHISORS' ABILITY TO CONTROL ACCESSIBILITY OF FRANCHISED FACILITIES.

The Eighth Circuit concluded that DIA had sufficient control over design and construction of the hotel in Wall, South Dakota to incur liability under Section 303.[2] The Eighth Circuit, however, missed or chose to ignore at least two fundamental realities of franchise arrangements. First, the Eighth Circuit failed to recognize the limited purpose of the franchisor's controls over design and construction of a franchised outlet: to maintain the

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[2] IFA expresses no view on whether the hotel was or was not in compliance with the ADA, an issue that DIA stipulated solely for purpose of the appeal and that the Eighth Circuit accordingly did not reach.

franchise network's brand identity (including both the appearance of the outlet and its capacity to deliver goods and services consistent with other network outlets). Second, the Eighth Circuit failed to acknowledge the franchisor's legal inability to carry out the responsibilities that its decision imposes on franchisors under the ADA.

Franchising concededly involves contract rights that are not typically present in non-franchised distribution arrangements. Such rights relate directly to the desired end product of a franchise system: to convey a uniform image and consistency of service to the public. In order to maintain uniformity of its image, the franchisor must prescribe standards for the appearance of franchised outlets and must have the means to confirm that the franchisee meets those standards.[3] DIA did no more than this in its franchise agreement with the South Dakota franchisee. The contract was not designed to give DIA affirmative obligations for, or control over, compliance with applicable laws; indeed, like most franchise agreements, the Days Inn contract specifies that the franchisee alone is responsible for such compliance (and DIA's Planning and Design Standards Manual further

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[3] Under the Lanham Act, a trademark owner must control the nature and quality of the goods and services offered by its trademark licensees; failure to do so may jeopardize the owner's trademark rights. *See* DIA's Petition at 7; 15 U.S.C. §§ 1055, 1064, 1127. *See also Taco Cabana International, Inc. v. Two Pesos, Inc.*, 932 F.2d 113, 120-21 (5th Cir. 1991), *aff'd*, 112 S. Ct. 2753 (1992); *Kentucky Fried Chicken Corp. v. Diversified Packaging Corp.*, 549 F.2d 368, 387 (5th Cir. 1977).

specifies that the franchisee is responsible for ADA compliance). The interest of DIA and other franchisors in reserving rights with respect to the design and construction of franchised outlets is solely to maintain a uniform system image and to protect the goodwill associated with the franchisor's trademarks. This legitimate franchisor interest should not become a trap for liability under the ADA or any other legal requirements relating to design and construction of a franchised outlet.

Instead of acknowledging the limited purpose and effect of DIA's contractual controls, the Eighth Circuit adopted an approach under which franchisors would be fair game for all manner of claims by third parties based on a franchisee's failure to comply with applicable laws. For example, franchise agreements also typically contain controls over the form and content of the franchisee's advertising, to ensure that the image that the franchisee presents to the public in advertising is consistent with the standards of the franchise network. These rights of control do not constitute an undertaking by the franchisor that the franchisee's advertising will comply in all respects with consumer protection laws. Similarly, reserving limited rights of control over design and construction of the franchisee's facility should not be treated as a legal obligation of the franchisor as to the facility's accessibility.

The Eighth Circuit also failed to recognize that franchisors like DIA have no practical means to ensure that franchised premises comply with the ADA. This distinguishes franchisors from business owners, operators, landlords, and tenants. Since each of these entities either

holds legal title to the premises or occupies the premises, they have the legal right and ability to comply with the ADA by directing changes to the property. That is not the case with franchisors vis-à-vis their franchisees' premises. Except in cases where they lease premises to their franchisees, franchisors do not hold title to the premises, have no security or lien interest in them, and do not occupy them. Although franchisors have the right to review their franchisees' operations to ensure compliance with the franchise agreement, franchisors are without any legal right to *trespass* upon the premises of their franchisees' businesses to reconstruct those premises to conform to the ADA's requirements. That right belongs solely to the franchisee as occupant of the premises, or, in the case of leased premises, to the landlord.

The Eighth Circuit concluded that DIA's power to terminate the franchise agreement for material breach "would have enabled DIA to ensure ADA compliance." *United States v. Days Inns of America, Inc.*, No. 98-1243 (8th Cir. August 6, 1998), slip op. (Appendix to DIA's Petition at B-8). This view is mistaken. Franchise agreements do frequently obligate the franchisee to comply with applicable laws; thus, if a franchisee fails to comply with the ADA, it may be in breach of its franchise agreement. But the franchisor would then only have the right to notify the franchisee of its breach, which customarily initiates a specified period within which the breach may be cured. Only if the franchisee failed to cure the breach within the applicable cure period could the franchisor lawfully terminate the franchise agreement. Furthermore, whether or not a cure period applies, if the

particular ADA violation is not sufficiently material to the franchise relationship that the franchisee would be deemed to have committed a material breach, no power to terminate the franchise agreement arises.

In any case, termination of the franchise agreement is not an effective mechanism for enforcement of the ADA. Many violations of the ADA are not clear-cut. If the franchisor simply terminates the franchise agreement based on its own determination that the franchisee is not in compliance with the ADA, it could be exposing itself to substantial liability for wrongful termination if its determination is later found by a court or arbitrator to be erroneous. If, on the other hand, the franchisor first seeks a declaration that the franchisee is in breach, the franchisor has to prove both the franchisee's noncompliance and materiality. Until it has established both elements, which could require a trial and one or more appellate proceedings, the franchisor is without power to terminate.

The Eighth Circuit's reliance on the franchisor's right to terminate is based on the unstated and faulty assumption that franchise systems are "command and control" regimes. In practice, franchisors primarily obtain compliance with system standards, not by issuing threats of termination, but by means of persuasion, negotiation, and instilling franchisees' confidence in the franchisor's system. The franchisor is not a "corporate headquarters" that can order franchisees to carry out physical alteration of their premises as if they were the franchisor's employees; the franchisor must deal with its franchisees as the independent contractors and business owners that they

are, within the scope of an ongoing, arm's-length commercial relationship defined by a franchise contract. A franchisor has no inherent right, and rarely has a contractual right, to take the action necessary to comply with the laws applicable to a franchisee's business, including the ADA. And once the franchise is terminated, the relationship of the franchisor and the franchisee ends. The franchisor might sue to collect monies owed by the franchisee, to compel de-identification of the franchisee's business, or to secure the return of its operations manual, but in all other respects, the relationship has ended and compliance by the franchisee with laws applicable to the business is no longer of concern to the franchisor or within its power to effect.

In short, the right of a franchisor to terminate a franchise agreement for a material breach cannot be equated with an obligation to directly comply with the law with which the franchisee has failed to comply. Threatening termination every time a franchisee fails to comply with a contractual requirement is not a practical approach for a franchisor that desires to manage its franchise network for growth and success. The Eighth Circuit simply expects too much of franchisors by, in effect, asking them to invoke their termination rights as leverage to compel ADA compliance by franchisees. And the Eighth Circuit could not really intend franchisors to

carry through on the threat of termination, since the franchisor's leverage disappears once termination occurs.[4]

Since franchisors who neither own nor lease their franchisees' premises have no practical means of enforcing compliance with the ADA by their franchisees, Congress could not have intended franchisors to be liable parties under Section 303. Interpreting the statute otherwise would lead to the absurd result of subjecting franchisors to liability under a law with which they cannot effectively comply. *See. e.g., Carpenters District Council of New Orleans & Vicinity v. Dillard Dept. Stores, Inc.*, 15 F.3d 1275, 1285 (5th Cir. 1994) ("A well-accepted canon of statutory construction requires the reviewing court to avoid any interpretation that would lead to absurd or unreasonable outcomes"); *H. Wayne Palmer & Assoc. v.*

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[4] In its brief to the Eighth Circuit, the Department of Justice ("DOJ") stated that a franchisor would fulfill its obligation under Section 303 by terminating the franchise agreement, even if the franchisee persisted in conduct violating the statute. This statement only highlights the futility of termination as an enforcement mechanism. Terminating the franchise agreement might satisfy DOJ's urge to punish ADA violators, but it would do nothing to remedy inaccessible conditions at franchised premises. Termination would leave both the franchisor and the franchisee significantly worse off, because they would forfeit most or all of the considerable resources invested to identify and qualify each other as business partners, to negotiate and sign the franchise agreement (and possibly ancillary agreements), to locate and obtain the site of the franchise, to arrange financing, to deliver and attend training programs, to develop the franchised facility, to recruit employees, and to undertake a myriad of other steps to prepare the franchise for business. This loss would occur with *no* offsetting benefit to persons with disabilities.

Heldor Indus. Inc., 839 F. Supp. 770, 779 (D. Kan. 1993) ("A construction of a statute should be avoided which would attempt to require the performance of an impossible act").

III. HOLDING FRANCHISORS RESPONSIBLE FOR THE CONDITION OF FRANCHISED PREMISES IS NOT NECESSARY FOR EFFECTIVE ENFORCEMENT OF SECTION 303.

One remarkable aspect of the Eighth Circuit's opinion is its lack of any explanation why franchisor liability for franchised premises under Section 303 is necessary for effective enforcement of the statute. As the cluster of cases filed by the Department of Justice against DIA amply demonstrates, there is always another party – namely, the franchisee – who owns and operates the franchised business and who, unlike the franchisor, is capable of physically bringing the premises into compliance with the ADA. There is no reason to believe that suits against the owner and operator of the franchised facility will not be an effective means to secure ADA compliance.[5]

If the assumption underlying the Eighth Circuit's judgment is that a franchisor is better able than its

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[5] *See United States v. Days Inns of America, Inc.*, Civ. Action No. 96-26 (E.D. Ky. September 30, 1998), slip op. (Appendix to DIA's Petition at F-2) (franchisee and other defendants who settled with the DOJ "agreed with Plaintiff to make all necessary repairs to conform to ADA standards . . .").

franchisees to bear the cost of ADA compliance, that assumption is unreliable. In fact, the opposite is true: franchisees will generally be better able to afford the cost of compliance for their individual units than will a franchisor for *all* of its franchised units.[6] If, instead, the rationale is to force franchisors to act as a private ADA police force over their franchisees, the Eighth Circuit cited no evidence of any such intention by Congress. Moreover, as discussed in Section II above, franchisors are not in a position to be effective ADA enforcers with respect to franchised facilities.

IV. THE EIGHTH CIRCUIT'S DECISION ON FRANCHISOR LIABILITY UNDER SECTION 303 DISCOURAGES VOLUNTARY EFFORTS BY FRANCHISORS TO PROMOTE ACCESSIBILITY OF NEW FRANCHISED FACILITIES.

IFA and its franchisor members fully support the desire of the Department of Justice to encourage compliance with the ADA's accessibility requirements. Franchisors acknowledge their responsibility for the compliance of facilities that they own, lease, or operate. In addition, many franchisors have voluntarily taken steps to educate their franchisees about the ADA. Franchisors, however, have no natural advantage over their franchisees in interpreting and understanding the ADA's requirements.

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[6] DIA, for example, licenses over 1,700 facilities. *See United States v. Days Inns of America, Inc.*, No. Civ. S-96-260 (E.D. Calif. January 8, 1998) (Appendix to DIA Petition at D-1).

Franchisors' design expertise and design function focus on system standards, as discussed in Section II. Although franchisors can sometimes draw on their experience with other company-owned or franchised outlets to provide information that may be useful to franchisees, or to guide franchisees to consultants who specialize in ADA matters, franchisors do not hold themselves out as experts regarding the ADA or other laws affecting design and construction of franchised facilities.

The Eighth Circuit held that DIA bears responsibility for the failure to design and construct the Wall, South Dakota hotel in compliance with the ADA if DIA had actual knowledge of an ADA violation. The court apparently believed that adopting this standard would enhance the level of compliance with the ADA at franchised facilities. Unfortunately, the ruling is likely to have the opposite effect, because it will discourage franchisors from taking affirmative steps to educate and assist franchisees.[7] Under the Eighth Circuit's ruling,

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[7] The Department of Justice's interpretation of Section 303 would have a similar effect. DOJ argued in the Eighth Circuit, and presumably would argue to this Court, that its interpretation of Section 303 furthers the goals of the statute by giving franchisors a strong incentive to ensure that franchised facilities comply with the ADA. However, DOJ also stated its view that a franchisor is *not* liable for franchised premises under Section 303 if the franchisor does not reserve contractual authority over design and construction; merely instructing the franchisee that its facility must comply with the ADA is not sufficient for liability. Given a choice between risking judgment on the compliance of franchised premises and surrendering authority over design and construction, franchisors might well conclude that the latter method is an easier and more certain route to avoiding ADA

franchisors are better off putting their heads in the sand, avoiding involvement that might later be deemed to demonstrate the franchisor's "knowledge" of an ADA violation at a franchised facility. This perverse incentive is likely to result in less, not greater, compliance with accessibility standards at franchised facilities.

IFA believes that franchisors should instead be encouraged to take an active role in helping franchisees make their businesses accessible to persons with disabilities. In order for franchisors to assume this role, such involvement must not expose the franchisor to liability if, despite the franchisor's efforts to promote full compliance, the franchisee's facility falls short of ADA requirements.

In theory, one means to reduce the disincentive to franchisor involvement created by the Eighth Circuit might be to delete the "knowledge" element imported into Section 303 by the court. But the Eighth Circuit clearly was not comfortable with a strict liability standard for franchisors under Section 303. Such discomfort is well justified, for the reasons expressed in Section II and footnotes 4 and 7 of this brief. The only other means to eliminate the Eighth Circuit's roadblock to franchisors' voluntary ADA education efforts is to correct the Eighth Circuit's erroneous interpretation of Section 303. IFA believes that DIA's interpretation of Section 303, under

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liability. Thus, DOJ's interpretation of Section 303 would only encourage franchisors to cleanse their design and construction standards of provisions that implicate the ADA.

which franchisors would be liable only when the franchisor is the owner, lessor, tenant, or operator of the franchised facility, would free franchisors to assist their franchisees on ADA matters and thereby enhance ADA compliance within franchise networks.

CONCLUSION

Based on the foregoing considerations of business practice and public policy, IFA respectfully requests that this Court grant DIA's petition for a writ of certiorari.

Respectfully Submitted,

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